

BEFORE THE  
Federal Communications Commission  
WASHINGTON, D. C.

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FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

Implementation of Sections of the  
Cable Television Consumer Protection  
and Competition Act of 1992

Rate Regulation

MM Docket No. 92-266

REPLY COMMENTS  
OF  
TELE-COMMUNICATIONS, INC.

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REPLY COMMENTS OF TELE-COMMUNICATIONS, INC.

Tele-Communications, Inc. ("TCI"), through its attorneys, hereby files its Reply Comments in the above-captioned proceeding. TCI reiterates its strong support for the implementation of a flexible, simple and efficient regulatory framework for cable services.

I. INTRODUCTION

The Commission has been assigned by Congress the complex task of supervising the reintroduction of rate regulation for some aspects of the cable industry. The assignment plainly is one of high risk: the overreaching exercise of regulatory powers threatens to reverse the substantial consumer gains that were achieved over the last decade.

The Commission's task is, as a practical matter, a very difficult one to fulfill. The industry utilizes a wide range of marketing approaches, cable plant, programming

services, and related equipment, such that national efforts to regulate an "average" cable system and the services it offers are inevitably imprecise as applied to any one specific system. Further, both rate regulation and other significant provisions in the Cable Television Consumer Protection and Competition Act of 1992<sup>1</sup> will require substantial revamping and rearrangement of the way the cable business has been conducted to date.

The practical difficulties are complicated by the strategic importance of cable to related industries, including broadcasters, other multichannel providers and telephone companies. Cable regulation in the past served more to benefit these types of private interests than to serve consumers. The Commission should be particularly wary of these interests once again seeking government assistance to shield them from other competition.

The Notice of Proposed Rulemaking in the instant proceeding sets forth literally dozens of questions surrounding the implementation of rate regulation.<sup>2</sup> In its initial comments,<sup>3</sup> TCI supplied responses to these questions with several guiding principles for the new regulatory regime.

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<sup>1</sup> Pub. L. 102-385, 106 Stat. 460 (1992) (the "Act").

<sup>2</sup> Implementation of Rate Regulation Sections of Cable Television Consumer Protection and Competition Act of 1992, MM Dkt. No. 92-266 (rel. Dec. 24, 1992) (the "Notice").

<sup>3</sup> The comments that TCI filed in the instant proceeding are cited herein as "TCI."

First, the direct regulatory effort must be targeted at the basic service tier. Congress intended for the Commission to promote the availability of a reasonably priced basic service tier, with only limited oversight of cable programming services, in order to minimize the risk of reversing positive trends in quantity and quality for the latter services. Second, the forms of regulation for the respective categories similarly must reflect Congress' appreciation of the risks inherent in reregulation. Thus, TCI supports the Notice's rejection of cost-of-service regulation for the basic service tier and its tentative adoption of a benchmark approach. Similarly, a "bad actor" approach, reaching only the highest rates and exceptional rate increases, should be used for cable programming services. Any programming offered on a stand-alone basis (even if also offered as part of a package) is by law held safe from regulation entirely.

TCI also urges, consistent with many other commenters, that the regulatory status of equipment follow the regulatory status of the services ordered by the subscriber. In addition, a maximum leased access rate principle, approximating the highest implicit fee charged by the cable operator, is also justified as the means for implementing the Commission's obligations under Section 621 of the Act.

The record to date provides ample support for these approaches. While a number of commenters assert conflicting conclusions, as will be demonstrated below, they do not provide

adequate support in law or policy for these departures.<sup>4</sup> The Commission may thus begin to move promptly to implement the proposals. The public availability of the Commission's data base created by the survey responses will contribute significantly to this endeavor by permitting full and complete analysis of various benchmark alternatives.

Finally, the Commission's efforts, given their complexity and the exceptionally limited timeframe mandated for the promulgation of rules, should be viewed as provisional. As discussed, enormous rearrangements and adjustments will be directly or indirectly required by the new Act. Thus, any set of rules should be treated as interim, subject to review of their consequences -- both intended and unintended.

## II. STANDARDS AND PROCEDURES FOR IDENTIFYING CABLE SYSTEMS SUBJECT TO RATE REGULATIONS

### A. The Act Contemplates a Cumulative Measurement of Penetration for Purposes of Effective Competition Calculations

As TCI set forth in the initial comments, the Act contemplates a cumulative measurement of penetration for

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<sup>4</sup> TCI has not attempted to address every issue raised in the proceeding by its opponents. Where issues are not here addressed, TCI relies on its initial comments.

purposes of effective competition calculations.<sup>5</sup> TCI pointed out that Section 623(1) specifically speaks of offerings of distributors that exceed 15%. Id. Had Congress intended the offerings to be measured individually it would not have used the plural form of the term "distributor". Furthermore, cumulative measurements comport with the Department of Justice's Herfindahl-Hirschman Index measurement of market competition.<sup>6</sup> Indeed, if there were more than six distributors, it is quite possible that no one of them would have a 15% penetration level. TCI at 13.

While the Consumer Federation of America and direct competitors of cable operators, such as Liberty Cable Company, acknowledge that the 15% penetration level measurement was intended to be calculated cumulatively, the associations of local franchising authorities assert that a cumulative measurement is prohibited under the Act.<sup>7</sup> NATOA points to

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<sup>5</sup> TCI at 12-13, see also, Comments of The Wireless Cable Association International, Inc., at 11.

<sup>6</sup> See Comments of Comcast Corporation at 13, n.17 ("Comcast").

<sup>7</sup> See Comments of Consumer Federation of America at 114 ("CFA"); Comments of Liberty Cable Company at 15 ("Liberty Cable"); Comments of The National Association of Telecommunications Officers and Advisors, National League of Cities, United States Conference of Mayors, and the National Association of Counties at 10 ("NATOA"). The Mayor and City Council of Baltimore also contend that such measurement should not be taken cumulatively. Comments of the Mayor and City Council of Baltimore at 6

(Footnote continued on page 6)

Conference Report language to support its position.<sup>8</sup> The Conference Report language, utilizing an example in which only one additional programmer is available in a particular market, is at best ambiguous, and more realistically inapt. Given the plain language of the statute, the Commission must conclude that penetration be measured cumulatively.

B. The Term "Offer" Should Be Interpreted to Include All Homes to Which Service is Technically Available and Generally Marketed

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As TCI stated in its comments, video programming should be deemed "offered" within the meaning of sections 623(1)(1)(B) and (C) if it is technically available to a household. TCI at 10-11. Such an interpretation of the term

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7 (Footnote continued)

("Baltimore"). Baltimore provides the Commission with no legal basis for its contention, only that "a multiple number of SMATVs coupled with wireless cable service, for example, cannot constitute 'effective competition.'" *Id.* There is no reason to interpret the plain words of the statute to mean anything other than that a cumulative measurement was intended.

8 NATOA at 10. NATOA cites the following from the Conference Report: "effective competition means . . . the franchise areas [sic] is served by at least two unaffiliated multichannel video programming distributors offering comparable video programming to at least 50 percent of the households in the franchise area, and at least 15 percent of the households in the franchise area subscribe to the smaller of these two systems." H.R. Conf. Rep. No. 862, 102d Cong., 2d Sess. 62 (1992) ("Conference Report").

"offered" is consistent with the Commission's calculus in the cable industry -- "homes passed". Id.

NATOA suggests that the term offer should be interpreted to require both technical availability and specific local marketing. NATOA at 15-16. TCI believes that this test is too stringent: The Commission should determine that video programming is "offered" to consumers if there is some local, regional or national marketing of the services such that consumers in the community in question reasonably can be assumed to be aware of the services. For instance, the existence of a regional or national 800 telephone number through which service can be ordered, coupled with technical availability should render the service "offered."

As TCI stated in its comments, cable services should be deemed to be offered to (and subscribed to) by each individual household, i.e., including each unit in a multiple dwelling unit. TCI at 11. Instead, NATOA would count MDU units as "households" only if the landlord permitted its tenants to choose a competitive service.<sup>9</sup> NATOA's suggested interpretation defies marketplace realities; competitors compete for the right to supply the services demanded by consumers and for the right to earn profits therefrom. It is

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<sup>9</sup> NATOA at 17, n.5.

irrelevant for these purposes whether a particular buying group centrally orders or even pays for such services.<sup>10</sup>

C. The FCC Should Define Multichannel Video Programming Distributors To Include All Distributors That Provide Multiple Video Programming Choices to Consumers

As TCI demonstrated in its initial comments, the Notice is correct in presuming that a multichannel video programming distributor offers "comparable video programming" if it simply offers multiple channels of video programming. Notice at ¶ 9; TCI at 13-15. This interpretation is consistent with the expansive statutory definition of multichannel video programming distributor. See Act, § 602(12). As TCI asserted, all distributors that offer multiple video programming choices are multichannel video programming distributors within the meaning of the Act including, DBS, TVRO, MMDS, SMATV and video dialtone service providers. TCI at 13-15.

Further, TCI believes that the FCC should not seek to establish an artificial standard for "comparable" video programming offered by multichannel video programming distributors. Contrary to NATOA's contention that comparability can be measured easily, the reality of the

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<sup>10</sup> In addition, the Notice's and NATOA's notion that only billed or billable customers be counted as households is inappropriate. Notice at ¶ 8; NATOA at 16-17. Contrary to that suggestion, billing is not an adequate measure of the total number of separate dwellings that actually pay for programming.

rapidly changing video marketplace would render an exact formula meaningless. NATOA at 13-14. Rather, the market should be left to define "comparability" in a manner that is consistent with the overall policy objectives of the Act. The Act expressly tells the FCC to "rely on the marketplace to the maximum extent feasible" to achieve a diversity of views. See Act, § 2(b)(1), (2).

NATOA sets forth a formula by which it proposes to measure comparability. NATOA at 14. In particular, the test would find that a multichannel video programming distributor's video programming is "comparable" where there is a "20-percent or less difference in the number of channels of programming" it offers. Id. A formula such as the one suggested by NATOA is inappropriate here. First, the advent of video dialtone and video-on-demand will make this formula inoperable, since such systems may offer one channel, but the one channel will afford a consumer a wide array of programming. Second, competition is in fact fostered by product differentiation among competitive offerings; NATOA's argument seems to assert that consumers are inexplicably better off with identical services being carried by all market participants. The fact that Congress acted in Section 628 to preserve exclusive programming contracts underscores this point, and demonstrates that Congress appreciated that "effective competition," and most importantly, viewers, could be aided by different distributors carrying different programming. Finally, the government should not put

itself into the business of determining "quality" or "sufficient number of channels" offered by competing services. Such scrutiny is suspect under the First Amendment, and meaningless in the rapidly changing video marketplace.<sup>11</sup>

### III. RATE REGULATION ALTERNATIVES

#### A. The Commission Should Adopt a Benchmark Approach for Basic Tier Regulation

TCI reiterates its strong support for a benchmark approach for basic service tier regulation. The record reflects a consensus that a benchmark will best serve the cable industry and its subscribers.<sup>12</sup> As Drs. Stanley M. Besen,

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<sup>11</sup> The Wireless Cable Association miscites testimony submitted by TCI's Vice President, Government Affairs in the FCC's Los Angeles Field Hearing in 1990. See Comments of The Wireless Cable Association International, Inc., at 14-15. In any event, the Wireless Cable Association, in its Program Access comments, has conceded that most of the programming services currently do business with wireless cable. See Comments of The Wireless Cable Association International, Inc., in Implementation of Sections 12 and 19 of the Cable Television Consumer Protection and Competition Act of 1992, MM Dkt. No. 92-265, at 17-18 (Jan. 25, 1993). If wireless competitors choose not to carry such networks, that is their competitive decision and it should not be used against cable operators for purposes of determining the existence of "effective competition."

<sup>12</sup> See e.g., TCI at 15-18; Comments of the Attorneys General of Pennsylvania, New York, Ohio, and Texas at 2 ("State Attorneys General"); Comments of Cox Cable Communications at 11-22 ("Cox"); Comments of Continental Cablevision, Inc. at 27-33 ("Continental"); Comments of Cablevision Industries Corporation at 14-30 ("Cablevision"); NATOA at

(Footnote continued on page 11)

Steven R. Brenner and John R. Woodbury stated in a paper appended to TCI's initial comments, it is important, however, that the benchmark be designed on a per-channel basis, rather than for the entire service tier.<sup>13</sup> Absent such a design, those cable operators whose must-carry or PEG obligations exceed the underlying average will be unfairly penalized. Further, the benchmark implementation must take account of the variety of marketing approaches used by the cable industry. TCI at 17. Substantial retiering and alterations in equipment offerings are anticipated by the new law.

TCI understands that the Commission staff intends to make publicly available its database collected from its industry wide survey. TCI commends the staff for this prompt and difficult task. Once such data are available for analysis, TCI intends to fully cooperate with and support the

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12 (Footnote continued)

40-44; Comments of National Cable Television Association at 15-26 ("NCTA"); Comments of Northwest Municipal Cable Council at 1 ("Northwest Council"); Comments of Time Warner Entertainment Company, L.P. at 21-25 ("Time Warner"); Comments of the Village of Schaumburg, Illinois at 7 ("Village of Schaumburg").

13 As part of its initial comments, TCI submitted an extensive analysis undertaken by Drs. Stanley M. Besen, Steven R. Brenner and John R. Woodbury with Charles River Associates that analyzes the economic effects of the Notice's proposal on the cable industry and its subscribers. Besen, Brenner and Woodbury, "An Analysis of Cable Television Rate Regulation," (Jan. 27, 1993) ("Besen et al.")

Commission's efforts to arrive at an appropriate benchmark for the basic service tier.

The record reflects that any cost of service regulatory framework for the basic service tier must be rejected.<sup>14</sup> As TCI explained in its comments, the costs and inefficiencies of cost of service regulation are well documented. TCI at 18-22; Besen et al. at 23-29. Furthermore, the administrative burdens associated with cost-based regulation would render the regulatory scheme inconsistent with the statutory mandate to prescribe regulations that "reduce administrative burdens on subscribers, cable operators, franchise authorities, and the Commission." Act, § 623(b)(2)(A).

Although ostensibly supporting a benchmark approach, the comments of the National Association of Broadcasters contend that basic service rates that meet or are below the benchmark should be subject to decrease if their costs are below those used to calculate the benchmark.<sup>15</sup> This position, however, inevitably transforms a benchmark approach into cost of service regulation. It would therefore produce all of the unintended costs recognized in its comments elsewhere.

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<sup>14</sup> See e.g., Cox at 8-11; Continental at 26; Cablevision at 12-14; NATOA at 44-46; NCTA at 13-14.

<sup>15</sup> Comments of National Association of Broadcasters at 7, n.10 ("NAB").

NAB supports its position by pointing to an alleged inequity in allowing cable operators to exceed the benchmark if cost-justified. Id. However, this exception is constitutionally mandated to avoid confiscatory ratesetting. Calculations based on service costs should be resorted to only as a means of avoiding a confiscatory benchmark rate in contradiction to the Fifth and Fourteenth Amendments.<sup>16</sup>

Further, at least some of the comments lump together the regulatory treatment of the basic service tier and of tiers of cable programming services. The failure to formally acknowledge the distinct regulatory status of these two categories is also inconsistent with the Congressional design. The Commission's task here cannot be fulfilled by designating two benchmarks -- rather, its approach for cable programming services must regulate only by exception. See discussion Section III(C), infra.

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<sup>16</sup> See Georgia Railroad and Banking Co. v. Smith, 128 U.S. 174 (1888) (government rate regulation cannot be so oppressive as to amount to the governmental taking of personal property without just compensation).

1. The Specific Proposals Presented to Date Are Unsatisfactory

TCI discusses the economic aspects of the three specific rate proposals in the record submitted by CFA, NAB and City of Austin et al.<sup>17</sup> below. Before addressing the specific problems with these proposals, it is important to gain overall perspective on what Congress intended to achieve by subjecting the cable industry to reregulation. Some of the comments suggest that the enactment of the new Cable Act was intended to be a punitive requirement for all cable rates to automatically decrease or for all future rate increases to come to an automatic halt. CFA insists that cable rates nationwide must decrease as part of the FCC's implementation scheme. CFA at 13. NAB takes this one step further, and demands that any increases which have occurred since November 1992 be summarily rolled back. NAB at 4-9. There is no basis for either construction.

The Act requires that the Commission ensure that cable basic service tier rates be reasonable. There is no congressional finding that all cable rates charged by all cable systems inherently fail the test of reasonableness, indeed, it is highly doubtful that Congress could by general statute

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<sup>17</sup> TCI refers to the Comments of Austin, Texas; Dayton, Ohio; Dubuque, Iowa; Gillette, Wyoming; Montgomery County, Maryland; St. Louis, Missouri; and Wadsworth, Ohio as "City of Austin, et al."

command that all cable rates be decreased. Given that the new Act will result in dramatic changes to the way in which cable services are offered by, inter alia, creating new basic service tiers, Congress could not have made any findings as to the rates for service tiers which were not even in place at the time of enactment. Further, there is nothing in the new legislation to suggest that it should be read as some sort of specialized price freeze.

CFA appears to be demanding the proverbial "free lunch." As TCI demonstrated in its comments, however, the consumer gains which have been achieved in the cable industry -- in terms of growth of services, plant investment, and increased programming quality -- have not been costless. TCI at 4. It was the rate increases permitted post-1984 which permitted these investments and encouraged the risktaking because cable companies had some assurance that they could reap the rewards. See Besen et al. at 9-14. Consumers shared in those rewards in a variety of ways as overall surplus increased. Id. at 13. CFA seems to think that all this came free, or worse, that future gains can be had for nothing. Congress at least recognized that there is no free lunch. See Cable Act, § 2(b)(3) ("It is the policy of the Congress in this Act to . . . ensure that cable operators continue to expand, where economically justified, their capacity and the programs offered over their cable systems").

There is a more important point beyond specific questions of statutory construction, however. Although TCI strongly believes that the Act was misguided, and indeed, constitutionally impermissible, it cannot be read and should not be read as a punitive, irrational act on the part of Congress. NAB has attempted to exploit the new Act as if its primary purpose were to enrich NAB's members and their shareholders. If this fact were not already obvious from NAB's own advocacy, the FCC need only consider the somewhat unusual case of a competitor urging the government to lower the price of another competitor to what would undoubtedly be confiscatory levels. To say the least, this is counterintuitive: one would expect that in a typical situation one market participant would not seek to reduce the price charged by a competitor. But of course, broadcasters do not compete with cable companies on price alone, rather, the two compete on quality and audience reach. Once this fact is accounted for, it becomes plain why NAB's advocacy is as desperate as it is: the broadcasters are looking to this agency to force drastic quality reductions in cable services. This goal no doubt serves the pecuniary interests of broadcasters and their shareholders, but it is directly counter to the public interest.

a. CFA's Proposed "Formulaic" Cost Approach Should Not Be Adopted by the Commission

In its comments, CFA offers the Commission a "formulaic" for the determination of the rates for the basic service tier and cable programming services. CFA at 86-93. While CFA provides no single statement setting forth the principles underlying the construction of this formulaic, CFA asserts that "Congress mandated cost-based price limitations designed to eliminate monopoly rents . . . ." In CFA's view, the formulaic could preclude "retiering harm and . . . preserve the incentive to provide a low priced basic tier." *Id.* at 96. Moreover, to prevent operators from diluting basic service offerings, the formulaic requires that the Commission establish quality standards for basic service, penalizing systems that fail to meet these standards. *Id.* at 97. Finally, CFA proposes that subscriber charges for new or not very popular cable programming services be capped at the CFA-formula determined average cost per channel. *Id.*

Even if it were permitted by the new Act (which it is not),<sup>18</sup> the CFA proposal is complex, incomplete, ill-defined, and ill-conceived. Its formulaic can best be characterized as "disincentive regulation." The proposal would, in effect,

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<sup>18</sup> The various ways in which the CFA proposal would violate the new requirements are set forth in Section III(A), supra.

freeze in real terms the total subscriber charge for basic cable service and expanded basic tiers at the rate level charged in 1986 for solely basic service. Adding any cable programming services to the 1986 channel lineups will increase an operator's costs, but the CFA formulaic will not permit the operator to charge a higher rate to cover those additional costs.

At best, the result of this approach would be to freeze the quality of basic and cable programming services at their 1986 levels. This would clearly harm consumers by denying them the substantial improvements in service quality that occurred between 1986 and 1993, and further, any future gains which could be expected. Furthermore, it is far likelier that the CFA proposal would reduce consumer welfare below that experienced even by 1986. Under the CFA formulaic, operators will be encouraged to drop cable programming services from all tiers because the price allowed to be charged would be independent of the number or the costs of services offered. Instead of merely maintaining, let alone increasing, the quality of cable programming services, operators have an incentive to reduce the number and the quality of those services. The more expensive and popular cable programming services will be forced to dilute their quality in order to reduce their charges to cable operators to a level that will induce their carriage at 1986 rates.

As discussed earlier, CFA appears to believe it has discovered the non-existent free lunch. Its approach reflects an apparent belief that, magically, the expansion in cable programming services experienced in the last decade had nothing to do with the rates charged, or the ability of operators to pay for additional programming.<sup>19</sup> But as discussed at length by Besen et al. as part of TCI's initial submission in this docket, the economic history of the cable industry suggest substantial sensitivity of the quality of cable programming services, and of the concomitant level of consumer satisfaction, to the rigidity of regulation. Besen et al. at 6-14. Indeed, the very period that CFA cites as evidence of how cable service flowered under regulation coincides almost precisely with that period of time when the FCC had dramatically reduced both federal and local micro-management of cable offerings.<sup>20</sup> That the growth in both cable penetration and the availability of cable programming services continued following rate deregulation provides further evidence of the fact that deregulation advanced the interests of consumers.<sup>21</sup>

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19 Throughout its comments, CFA erroneously treats the "not unreasonable" rate standard for cable programming services as equivalent to the "reasonable" rate standard for basic service. See CFA at 80-83.

20 See CFA at 41-48; Besen et al. at 8-9.

21 See Besen et al. at 9-14. CFA criticizes the only study that was conducted to estimate the effect of cable

(Footnote continued on page 20)

Put simply, what CFA ignores is that prices that are too low can be as, or even more, harmful to consumers than prices that are too high. By discouraging the carriage of relatively costly but highly valued cable programming services, consumers will find cable service less attractive, cable penetration is likely to fall, and consumer welfare will decline. As discussed earlier, there is no requirement that the FCC mindlessly force cable prices lower. Congress intended for the FCC to create a regulatory regime in which a reasonably priced basic service tier could be offered while minimizing the harm to the development of cable programming services. Indeed, an express purpose of the Act is to "assure that cable communications provide and are encouraged to provide the widest possible diversity of information sources and services to the public." Act, § 601(4).

As noted above, the CFA proposal would make it unlikely, if not virtually impossible, for cable operators to continue to offer expensive and highly valued cable services to subscribers, would likely have adverse financial consequences

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21 (Footnote continued)

deregulation on consumers as an "eleventh hour" attempt to defeat the cable legislation. That study -- which concluded that consumers had experienced substantial gains from the improved quality of cable service -- was completed two-and-one-half years before the legislation passed. Equally significant, CFA's own "trend analysis" indicates that following the 1986 deregulation, actual cable subscribership exceeded that which would have been predicted by the pre-1986 subscriber trend.

for cable operators, and would skew new programming services to those that are less costly to produce.

To see this point somewhat more clearly, suppose that it were costless to add channel capacity to whatever number of channels were offered in 1986. To keep the example simple, suppose that between 1986 and 1993, there was no inflation<sup>22</sup> and operators earned no advertising revenue.

Consider a cable operator in 1986 offering a 10 channel basic service (on a 10 channel system) for \$10. Assume that five of those channels are occupied by must-carry stations and five are occupied by cable programming services in what CFA calls the top 30, the significance of which will be apparent below. The operator's license fee per subscriber per month for each of those five cable programming services is \$.50. The operator also offers these five services through 1993.

Now, assume that in 1993, the operator is offering subscribers 50 activated channels (net of leased access channels).<sup>23</sup> These consist of the same 10 services as before,

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22 In the formulaic, CFA suggests that the GNP price index be used to adjust for inflation. CFA at 91. TCI assumes that CFA refers the Commission to the GNP deflator, an index frequently used to gauge very broadbased changes in prices.

23 Among other omissions, the CFA formulaic does not indicate how channels offered on a la carte or per-event basis should be counted in the activated channels calculation. Nor does CFA make any attempt to distinguish between rates charged by systems that

(Footnote continued on page 22)